No. 10,386

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.

PACIFIC POWER & LIGHT COMPANY,

and

AMERICAN POWER & LIGHT COMPANY,

Petitioners,

vs.

FEDERAL POWER COMMISSION,

Respondent.

PETITION FOR REHEARING

JOHN A. LAING,
HENRY S. GRAY,
Public Service Building,
Portland 4, Oregon,
Attorneys for Petitioner,
Pacific Power & Light Company;

A. J. G. PRIEST,
Two Rector Street,
New York 6, New York,

ADRIAN L. FOLEY,
14 Wall Street,
New York 5, New York,
Attorneys for Petitioner,
American Power & Light Company.

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PETITION FOR REHEARING

Petitioners respectfully pray, for the reasons hereinafter set forth, that they be granted a rehearing as to the decision entered herein on March 10, 1944. The decision affirms an order of the Federal Power Commission dated November 24, 1942. Paragraph H of said order directs Pacific "to dispose of" the amount of $2,741,591.66 classified in Account 100.5, Electric Plan Acquisition Adjustments, by charging said amount to Account 537, Miscellaneous Amortization, in ten equal annual charges commencing with the calendar year 1942. This $2,741,591.66 represents the excess, over so-called "original cost" of the cost to Pacific or to American, of the cost of assets acquired in arm's-length transactions with former owners, who were in no way affiliated or associated with either Pacific or American.

The Court's opinion appears to rest on the assumption that the evidence supports a finding that the amount in Pacific's Account 100.5 "represents essentially a capitalization of prospective earning power, having no continuing place in the accounts of a public utility." This assumption is grounded on opinions of the Commission's staff, opinions which we submit are not supported by anything which may be regarded as substantial evidence, particularly in view of the decisions of the Supreme Court in the cases of *Amer. Tel. & Tel. Co. v. United States,* 299 U. S. 232 (1936), and *Northwestern Electric Co. v. Federal Power Commission,* 88 L. ed. 394 (Adv. sheets—decided January 31, 1944). Pronouncements of so-called experts which are contrary to the opinions of the highest court in the land cannot be treated as substantial evidence. The decisions in the two cases above cited do justify "writing-off" items of a *fictitious nature,* but they equally imply the impropriety of ordering a write-off of so-called "intangibles" of the nature of those present in Pacific's 100.5 Account.

We respectfully submit, not only that the opinions of the Commission's staff failed to take into account the nature and enduring quality of the so-called "intangibles" here involved, but also that this Court has been misled into holding that such opinions constituted substantial evidence by erroneously construing the decisions in the two Supreme Court cases above cited as permitting the Commission to order the writing-off of "intangibles", regardless of whether they represent fictitious or real values. A careful analysis of these Supreme Court opinions will demonstrate, we believe, that they do not sanction an ordered writing off of the so-called intangibles involved in

this case. The reasons why such "intangibles" may not be so required to be written-off have been presented in Petitioners' argument and briefs. These points will not be reargued here, but some reference to such reasons is necessary to demonstrate the illegality and unconstitutionality of the order under consideration, under any reasonable interpretation of the Supreme Court's opinions.

ORIGIN AND NATURE OF SO-CALLED INTANGIBLES

As pointed out on pages 6 to 9 of Petitioners' opening brief herein, American and Pacific acquired at various times, in arm's length transactions, beginning early in 1910, a large number of operating utility properties as going concerns. These were purchased with the object of combining the properties, and their then developed business and trained personnel and recognized strategic locations, into an integrated public utility system, and of thereby rendering better service and at lower cost to existing and future customers in areas served. Also, as pointed out in Petitioners' opening brief on pages 20-22, these local utility properties, by reason of the pioneering and development of business by their then and former owners, and of their favorable locations, had a value very much greater than their recorded original cost. If such increases in value, which came about as a natural consequence of the efforts, foresight, and sacrifices of the former owners, plus improvements in the art of production and distribution of electric power, and the relation of the several projects to each other as potential parts of a large and unified system, are "intangibles" which "tend to disappear" and should therefore be written-off the books, then a large part of the value inherent in San Francisco business real

estate or in any successfully pioneered business, should likewise be written-off the books of the current owner who purchased the property from the pioneer or his successor.

The fact is that any true increment of value of every property or business which, in an arm's length transaction, will bring a price in excess of the original cost of the physical assets, by reason of technological improvements, strategic location, or other valuable characteristics inherent in the physical assets, would be subject to classification on the Commission's theory as an "intangible" which tends to disappear. The value of gold might disappear if it ceased to be a unit of monetary value, but no one would have the temerity to argue that the difference between the cost of a plot of land before gold was discovered thereon, and its sale price after the discovery of gold, was an intangible which must be written-off. The so-called intangible values purchased and paid for by Pacific are even more permanent and less speculative, since they were rooted in and inseparable from the projects and businesses purchased, and are now important elements of Pacific's integrated electric utility system; and the life of these values is not restricted by the wearing out of individual poles or meters, but is continuous throughout the life of the system in which these values are imbedded. These so-called intangible values, fixed in arm's length transactions, combined with the original costs of physical assets, represented at the time of purchase the true value of the properties and business acquired by Pacific. Although individual items of the physical property originally purchased may disappear, in the sense of being replaced by other items of similar or different character, the intangible values inher-

ent in each of the individual properties purchased will continue as an integral part thereof, so long as the communities which they serve continue to exist and to use electric service.

Even if such intangible values should be rooted in or associated with prospective earning power, their status in that respect is no less entitled to continued recognition, so long as the values survive, than any other true element of value at its purchased cost. As we shall demonstrate, the Supreme Court of the United States, however, has refused to apply, even to public utilities, the drastic doctrine that true increments of value, regardless of the causes or circumstances responsible for them, must be written off.

It is suggested by this Court in its opinion that the physical properties with which these intangibles were associated have not been shown to be in existence today; but any such suggestion misconceives the nature of Pacific's investment in these intangibles, and confuses the individual pieces of wire, poles or other equipment with the organized unit of which the individual physical items are merely easily replaceable parts. That the so-called intangible values purchased by Pacific are all in existence today, and are actually more valuable than ever, is fully demonstrated by a casual reading of Exhibit 15, pp. 1-115 (R. 119-130, 143).

True and lasting increments of value, appraised and purchased in arm's length transactions, as distinguished from fictitious increases, are not the kind of intangibles that can be legally and constitutionally ordered written off the books, as a careful analysis of the opinions in *Am. Tel. and Tel Co. v. United States* (supra) and *Northwestern Electric Co. v. F. P. C.* (supra), will show.

ARGUMENT

This Court points out that Mr. Justice Cardozo, at page 242 in the Telephone case, intimated that the acquisition cost in excess of original cost could properly be disposed of after the character of the item had been determined. This Court, however, overlooked his equally strong statements that "only such amount will be written-off" from telephone Account 100.4, "as appears . . . to be a fictitious or a paper increment", and that amounts which represent "an *investment* which the accounting Company has made in assets of continuing value will be retained in that Account until such assets cease to exist or are retired." Although these broad characterizations of the type of incremental value which should remain in telephone Account 100.4 are not defined in detail by Justice Cardozo, (probably because he was merely concerned at this point with explaining that the definition of said Account 100.4 did not necessarily make the classification of items in that account arbitrary) Justice Cardozo's discussion makes it perfectly clear that any amount paid for a property or business in excess of original cost, fixed in an arm's length transaction and not excessive in amount, could not be *"withdrawn from recognition as a legitimate investment."*

In discussing the objective of the telephone accounting system, at 299 U. S., page 239, Justice Cardozo referred to the fact that transactions giving rise to the items required to be classified in telephone Account 100.4 are often between affiliated companies, and that buyer and seller in such circumstances may not be dealing at arm's length, or the price agreed upon between them may be a poor criterion of value; and that, even in transactions be-

tween rival systems, there is the possibility that nuisance value rather than "market or intrinsic value for the uses of the business" fixed the price. It is for these reasons that spreading the cost figures on the record may facilitate the work of the regulatory commission. Here is a clear recognition that all amounts properly placed in telephone Account 100.4, the equivalent for present purposes of Pacific's Account 100.5, represent an increase or decrease over the original cost of a business when first dedicated to the public use, plus all proper outlays and deductions up to the date of purchase; and that, to the extent any such amount represents an increase fixed in a bonafide transaction, it represents a true increment in value at the time of purchase and must be retained in Account 100.4 while such value continues. According to the Federal Power Commission, however, such an increment is an intangible which must be written off, regardless of the fact that it represents a true increment of value at the date of purchase, and was fixed in an arm's length transaction not subject to attack as imprudent from the purchaser's standpoint, and of the further fact that such increment of value continues to inhere in the property so purchased.

Mr. Justice Cardozo does not accept that point of view. He says, at 299 U. S. 240, that if such items must be arbitrarily written off as contended, there would be force in the contention that "the effect of the orders is to distort in an arbitrary fashion the value of the assets"; and he further states, on page 240, in answer to any such proposal:

> "The Commission is not under a duty to write off the whole or any part of the balance in 100.4, if the difference between original and present cost is a true increment of value. On the contrary, only such amount will be written off as appears, upon an application for appropriate directions, to be a fictitious or paper increment. This is made clear, if it might otherwise be doubtful, by administrative construction."

Not content, however, to submit the question on the basis of his own definition of the account and explanation of its operation, he requested the Commission to reduce to writing an interpretation of the account as follows: (p. 241)

> "that amounts included in Account 100.4 that are deemed, after a fair consideration of all the circumstances, to represent an investment which the accounting company has made in assets of continuing value will be retained in that account until such assets cease to exist or are retired; and, in accordance with paragraph (C) of account 100.4, provision will be made for their amortization."

Then, to make doubly sure that such true increments in value would be retained on the books, he recited that this construction would be binding upon the Commission, and he took pains to distinguish the case of *New York Edison Co. v. Malbie* (244 App. Div., 685; 271 N. Y. 103) which condemned a similar account as unconstitutional, because it had required the account to

be written off in its entirety out of surplus, whether the value there recorded was *genuine or false.*

And then, by way of summary, and seemingly as an admonition to the Commission, he emphasized the necessity of recognizing as *legitimate investments* incremental values properly fixed, as follows:

> "The administrative construction now affixed to the contested order devitalizes the objection that the difference between present value and original cost is withdrawn from recognition as a legitimate investment."

This sentence makes perfectly clear that any difference between "original cost" and the true value at the date of purchase is a *legitimate investment,* which must be permitted to remain on the books of the purchasing company as an investment so long as such incremental value exists.

Mr. Justice Roberts, speaking for the present Supreme Court in the case of *Northwestern Electric Co. v. Federal Power Commission* (supra), seemed equally impressed with the necessity of recognizing such true incremental values as legitimate investments, when he said:

> "Although if American had purchased the assets of Northwestern it might have been allowed to place among its assets on its own books the actual cost to it of the physical property of Northwestern, the fact is irrelevant upon the question whether Northwestern may carry a fictitious asset account representing estimated value of capital stock issued neither for money nor for property at exchange value."

Here again, although the Supreme Court recognizes the right of the Commission to establish a system of accounts classifying the assets, it clearly appears that the Commission's power to order a write-off of book value must rest upon a determination that such "values" were and are fictitious. Northwestern was not allowed to maintain a "fictitious asset account representing estimated value of capital stock issued neither for money nor for property at exchange value"; but, if American had purchased the assets of Northwestern instead of its stock, the cost to it (American) could have been carried on American's books as an asset. In other words, the write-off was approved because the amount was fictitious and not a true increment of value so far as Northwestern was concerned, and *not because* incremental values are intangibles which tend to disappear or have no place in the accounts of an electric public utility.

There is no doubt that the Federal Power Commission, on the authority of the Supreme Court cases above cited, may classify the difference between original cost and acquisition cost in Account 100.5, and that the Commission may examine and take evidence to determine whether or not this difference represents a true increment in value; but the Commission may not order this difference written off unless substantial evidence, after opportunity to present all relevant evidence on the subject is permitted, demonstrates that the difference constitutes a fictitious or paper increment, or no longer exists as value.

In the instant case there is not a scintilla of evidence that the difference between "original cost" and acquisition cost represents a fictitious or paper increment, or that it was fixed by a fraudulent transaction or even by an improvident or careless negotiation. On the contrary, it was

conceded on the argument, and this Court in effect finds, that all the transactions involving sums placed in Account 100.5 were arm's length transactions, that the payments were bona fide, and that Pacific's investments therein were prudent.

In such circumstances, it is our sincere conviction that this Court will desire a re-argument of this case, if there is a reasonable ground for our belief that the above analysis represents the law as declared by the Supreme Court. We are equally sincere in our conviction that this Court fell into error,

> first, by assuming, because the Supreme Court has upheld the right of the Commission to adopt and enforce its system of accounts, that the Supreme Court has also sanctioned the Commission's asserted power to order the write-off of all intangibles, regardless of whether or not they represent true incremental values; and
>
> second, by assuming, because Mr. Justice Roberts in the Northwestern case declined, unless the plan adopted by the Commission were "obviously arbitrary", to "determine what is the better practice" of disposing of a fictitious write-up, that the Supreme Court placed the opinion testimony of the Commission's staff members above court scrutiny, even when such opinions relate to fundamental property rights with respect to which the highest Court in the land has already expressed a controlling opinion.

The first point has been fully explored above. As to the second point, it seems obvious that opinion testimony,

even if it should represent the views of an unbiased expert, lacks every element necessary to qualify such opinion as evidence, not to mention *substantial evidence,* if it is not based on and supported by fundamental facts, or if it clashes head-on with a determination of the law by the highest court in the land. In such case, the accountant (biased or unbiased) thus convinced against his will, of course may retain the same opinion still, but the opinion can have no evidentiary value. We believe we have shown that there are no facts in this case which would justify substituting any accountant's opinion, on what is fundamentally a matter of law and constitutional rights, for the determination of the Supreme Court dealing directly with the subject matter.

Indeed, the record is devoid of any factual evidence to support the opinion of the Commission's staff. There is no evidence that the incremental values recorded in Pacific's Account 100.5 came into being by reason of imprudent or improper motives or dealings, or that such values are now, or were when the purchases occurred, fictitious or paper increments. There are no fundamental facts in the record upon which an expert could or would be justified in stating that these particular so-called intangibles tend to disappear, particularly since the Commission's staff admits that there is no necessary relationship between the life of tangibles and intangibles. R 505.) There are no facts in the record showing that such values have disappeared or that they will disappear. There is the mere enunciation by the Commission's staff members of a general theory that "intangibles tend to disappear", followed by their opinion that intangibles have no place in the accounts of an electric public utility, and that the so-called intangibles here involved should therefore be written off.

The so-called evidence upon which the Court relied for the decision in this case thus is merely a statement of the predilections of the Commission's staff members as opposed, in our view of the case, to decisions of the Supreme Court of the United States on what is fundamentally a legal question. Such predilections are not substantial evidence or any evidence, to say nothing of their incompetence as evidence when unsupported by any facts applicable to the particular case and the circumstances here involved. The glaring deficiency in such opinion testimony as evidence is again apparent from the admission of the Commission's staff that its accountants have no function in determining what shall be done with balances placed in Account 100.5—it being a function of management and the Commission. (R. 501-503.) Petitioners objected to all the testimony offered by the staff members relating to this subject, on the ground that they were not qualified to express opinions on the matter. (R. 487-488, 518.)

This Court apparently justified the exclusion of our offer of fair value testimony on the ground that this is not a rate proceeding. That this is not a rate proceeding is conceded, but in thus disposing of the question, the Court seems to have lost sight of the fact that one of the principal reasons advanced by the Commission's staff, in support of its theory that incremental values have no place in utility accounts, is the staff's own *say-so* that such values may have no value whatever for the purpose of rate making or for security purposes" (Record, 533). Cost, however, is one of the elements which must be considered and weighed in arriving at a rate base, and to the extent that evidence of the present value of the Company's assets throws lights upon the continued existence of the pur-

chased incremental values (labeled intangibles in this instance by the Commission) which were and are properly recorded in Account 100.5 in accord with decisions of Mr. Justice Cardozo and Mr. Justice Roberts, such testimony was relevant, material, and competent with respect to the issues involved.

If such testimony had been admitted, it would have established beyond doubt that such so-called intangibles not only represented true increments of value at the time of purchase, as distinguished from fictitious or paper increments, but also now represent values greatly in excess of the incremental values presently recorded in Account 100.5. The exclusion of this testimony, therefore, was error, and constituted a denial of due process which requires the reversal of the Commission's order of November 24, 1942. This conclusion is inevitable, even if we entirely ignore the unfair and arbitrary ruling permitting the Commission's staff members to support their opinion testimony on rate making principles, while denying the Petitioners the right to introduce factual testimony to rebut such opinions, as discussed on pages 12 and 13 of Petitioners' Reply Brief.

In the case of *Baltimore & O. R. Co. v. United States,* 5 F. Supp. 929, dealing with the duty of an administrative agency to take and weigh evidence, the court said at page 931: *"To refuse to consider pertinent evidence introduced is arbitrary action."* (Emphasis supplied.) It necessarily follows that refusal to admit pertinent evidence is equally arbitrary action and denial of due process. See also: *National Labor Relations Board v. Union Pacific Stages,* 99 F. 2d (C.C.A., Ninth Circuit) 153, 177. *Chicago Junction Case,* 264 U. S. 258, 265.

There is perhaps only one further point which requires additional discussion. The Petitioners contended, both in their application for rehearing (Record, 68-69, 76-77), and in their petition for review (Record 102-105), that any required disposition of the whole or any part of the amounts recorded in Account 100.5 by amortization or otherwise would constitute a taking of property without due process. The Court, nevertheless, appears to acquiesce in the novel theory advanced by the Commission that Petitioners, in objecting on constitutional grounds to any disposition in whatever nature or manner, through Account 537 or otherwise, must actually go farther; that Petitioners must assume that their objection will be overruled; and that they must affirmatively suggest in advance the use of an account which might make the ordered write-off under attack less burdensome though still objectionable. This is tantamount to requiring the Petitioners to discredit in advance their own objection. If adhered to as a basis of decision, the Court is plainly in error. (See Petitioners' Reply Brief, pages 11-12.)

Since the impropriety of presently requiring any disposition of the sums recorded in Pacific's Account 100.5 seems obvious on the present record, any discussion of the point beyond reference to pages 26-31 of Petitioners' Brief and pages 11-12 of Petitioners' Reply Brief is perhaps unnecessary. However, since the subject will undoubtedly be the subject of argument on rehearing, we respectfully point out that any amortization through an account which has the result of releasing the consumer from his admitted obligation to pay for the use of Pacific's assets is a taking of Petitioners' property without due

process. Such would be the effect of requiring disposition through charges to Account 537.

In view of the great importance of the issues here involved, and of the public interest therein, we trust that this Court will find that further oral argument and written briefs are necessary for the proper consideration of Petitioners' contentions herein.

Wherefore, upon the foregoing grounds, and for other reasons appearing in Petitioners' briefs, it is respectfully urged that a rehearing be granted herein before all the Circuit Judges of the Ninth Circuit (See: *Textile Mills Sec. Corp. v. Com. of Int. Rev.*, 314 U. S. 326; *Pacific Gas and Electric Company v. Securities and Exchange Commission,* 127 F. 2d. 378), and that the mandate of this Court be stayed pending the disposition of this petition.

Respectfully submitted,

JOHN A. LAING,
HENRY S. GRAY,
Public Service Building,
Portland 4, Oregon,
Attorneys for Petitioner,
Pacific Power & Light Company,

A. J. G. PRIEST,
Two Rector Street,
New York 6, New York.

ADRIAN L. FOLEY,
14 Wall Street,
New York 5, New York.
Attorneys for Petitioner,
American Power & Light Company.

CERTIFICATE OF COUNSEL

I, JOHN A. LAING, an attorney for the Petitioner Pacific Power & Light Company, do hereby certify that in my opinion the foregoing Petition for Rehearing in the case of Pacific Power & Light Company and American Power & Light Company, Petitioners, v. Federal Power Commission, Respondent, No. 10386, is well founded and that it is not interposed for delay.

JOHN A. LAING.

Dated: March 27, 1944.